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August 9, 2002

BY HAND AND E-MAIL

Mary L. Cottrell, Secretary
Department of Telecommunications
and Energy
One South Station, 2nd Floor
Boston, MA 02110

Re: Fitchburg Gas and Electric Light Company, D.T.E. 02-40

Dear Ms. Cottrell:

Enclosed for filing in the above-referenced proceeding, please find an original and eight (8) copies of the Initial Comments of Fitchburg Gas and Electric Light Company.

Thank you for your attention to this matter.

Very truly yours,

Scott J. Mueller

SJM/va
Enclosures

cc: Jeanne Voveris, Esq., Hearing Officer
Ron LeComte, Director, Electric Division
Joseph A. Rogers, Assistant Attorney General
Matthew T. Morais, Esq., DOER
Service List

BS82701v1

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service	)	D.T.E. 02-40

**INITIAL COMMENTS OF
FITCHBURG GAS AND ELECTRIC LIGHT COMPANY**

I. INTRODUCTION

Fitchburg Gas and Electric Light Company ("FG&E") files these comments in response to the Notice of Inquiry ("NOI") and Order Opening Investigation issued by the Department of Telecommunications and Energy ("Department") on June 21, 2002, into the provision of default service. The Department opened this inquiry to investigate all aspects of the manner in which default service is provided.

The Department held a public hearing at its offices on July 23, 2002, and immediately following the public hearing held a technical session.

The Department's stated objective in conducting this investigation is to ensure that the manner in which default service is provided is compatible with the development of an efficient competitive market, that barriers to consumers' participation in the competitive market are removed, and that a comprehensive evaluation of price components, pricing options and procurement schedules and strategies are in place.

FG&E appreciates the opportunity to provide written comments regarding the current state and future provision of default service in Massachusetts. The power of competitive markets holds the best opportunity for fostering the greatest benefits of electric restructuring. In FG&E's view, the best approach will be one that: (1) maximizes competitive market activity prior to the end of the Standard Offer period; (2) provides an appropriate "last resort" safety net to those who have come back to utility service; and (3) makes provisions for a seamless and smooth transition, for residential and small commercial customers when Standard Offer ends.[1]

II. COMMENTS ON THE DEPARTMENT'S DEFAULT SERVICE POLICIES

1. The Price Components of Default Service Should Reflect Full Cost.

A major requirement in the development of competitive markets is that the provision of default service by distribution utilities must be that of a Provider of Last Resort, not a Provider of First Choice. Default service as presently designed satisfies the bulk of residential and small commercial load at the lowest available commodity price, maximizes load and customer diversity benefits at no cost to the customer, and provides modest price averaging and supply risk mitigation at little or no cost. These features are advantageous to customers in the short term but detrimental to long-term market development.

Default service should be priced to include all factors reflecting its full costs. These costs should include: (1) the full cost of supply acquired from the market, including the cost of meeting portfolio standards, the cost of load following, the cost of risk premium for loads which leave and return, the cost of bulk supply transmission including locational marginal costs, and the like; (2) the administrative costs of acquiring default service supply and the cost of managing data and information flow including reporting of customer and load data, customer billing and service, and

[1] These customers, as the Department knows, face the fewest competitive options today.

the like (excess revenues could be credited to base rates or used to offset transition costs); (3) the cost of uncollectible accounts; and (4) the cost of losses.

2. Default Service Should Be Priced At Market.

Default service should continue to be reflective of market conditions in order to support continued competitive market development and to avoid significant discontinuities between the market price and the default service price. Longer-term price smoothing and longer-term solicitations increase the risk of discontinuities between market prices and default service prices to the detriment of consumers and the goal of a robustly competitive wholesale market.

The current semi-annual procurement, with monthly and six-month pricing, is not unreasonable and quarterly pricing would also be feasible.[2] Re-pricing of default service on a semi-annual basis is not dissimilar to the pricing pattern of other energy commodities purchased by retail consumers, such as propane, natural gas, heating oil or gasoline.

Clearly, there are competing desires in play with the solicitation of the lowest commodity cost for default service and the desire to spur customers into the competitive market. Massachusetts's customers have been accustomed to rate continuity and the avoidance of rate shock, which were stalwart regulatory policies in a bundled electricity market. The Department's most difficult regulatory challenge has been and continues to be how to reconcile these competing objectives; how to move customers successfully into a competitive market framework without unduly startling a public psyche that still expects the Department to provide rate continuity and protect consumers from rate shock.

[2] The electric fuel charge used to be adjusted on a quarterly basis.

3. **Default Service Procurement Should be Based on a Last Resort Model.**

The wholesale market understands current default service products and the solicitations are yielding competitive pricing. However, the objective of this inquiry is to foster movement to the competitive market, specifically for residential and small commercial customers. As long as default service is a "competitive" option then the risk remains that it will continue to be viewed as the "first choice." In FG&E's view, default service in the ideal should be used for short periods by customers while they are shopping the market.

Default service procurement should be matched with the pricing strategy adopted by the Department. Procurement should insure that suppliers are responsible for all aspects of the full requirements service, including locational marginal pricing ("LMP") and generation information systems, or GIS-based, portfolio standards. This responsibility needs to be a "retail" service vs. wholesale and should include all the price components as mentioned in Section II.1. In addition we believe that including all other costs in the retail price is an important step in improving the price signal of default service. Beyond this, we are interested in hearing any other ideas that can help move the distribution utility from being in the role of "provider of first choice".

III. DEFAULT SERVICE PROPOSALS

1. **FG&E is Concerned that DOER's Suggestions May Not Result in A Market-based Default Service Model.**

The Massachusetts Division of Energy Resources ("DOER") has suggested the following changes to the procurement of default service: (1) for all classes, procure supply on a staggered schedule in smaller quantities, more frequently; (2) for residential customers, lengthen the term of procurements to two years; (3) for Standard Offer customers, contracts beyond February 2005 serve a *pro rata* share of their demand; and (4) limit the amount of demand one supplier can serve at one time.

FG&E has a number of concerns regarding the DOER's suggestions. If instituted on a permanent basis, the DOER recommendations appear likely to yield a prolonged transition period. The rolling-average pricing may contribute to a cyclical bias in market behavior. The DOER suggestions will also tend to smooth the peaks and valleys of default service pricing. Common economic principles tell us that when market prices drop below the average default service price, competitive market activity would be stimulated; however when market prices rise, competitive market activity would cease. Default service customers are less likely to "shop" so long as they perceive that they are more likely better off economically under default service in the long run. Competitive markets may be hindered, and customer confidence in and incentive to understand the markets -- so critical to customer participation -- may falter. Competitive suppliers will be less willing to invest in the market under these conditions, which may result in less numbers of participating competitors and a reduction in market diversity of participants and products/services. Default service should be the last resort, not the first choice.

The DOER's rolling average pricing, in FG&E's view, would effectively act as a price cap over a relatively long period of time, when compared to pricing that is likely to occur during periods of significant market adjustment. As recent experience has borne out, market adjustments tend to drive customers to default service, reducing competition. In sum, default service should not have an economic preference or it will continue to trounce competitive supply options in attracting load.

Furthermore, the size and timing of suggested solicitations by the DOER are not feasible for FG&E. FG&E's current default service load is approximately 15MW. Soliciting 1/8th of this load on a quarterly basis or, 1/4th of this load on a semi-annual basis would involve multiple solicitations of well under 4MW and possibly less than 2MW. FG&E procures its current default service load on a two-group basis. The result of dividing this load into 1/8th or 1/4th fractions would likely eliminate bidder interest in the default service load. In addition, solicitations done in this manner will mask market price signals and may not meet the regulatory requirement that default service be priced at monthly market prices.

The DOER suggestion that default service bidders be Department-licensed retail suppliers in Massachusetts is also a concern for FG&E since it could eliminate many of the likely bidders, leaving no suppliers of default service. In fact, a majority of the bidders in response to FG&E's solicitations have not been licensed retail suppliers. Therefore, FG&E sees any requirement for bidders to be licensed retail suppliers in Massachusetts as a source of concern and contrary to the goal of achieving viable competitive offers for default service .

IV. CONCLUSION

FG&E believes the best approach to the design of default service is one that: (1) maximizes competitive market activity prior to the end of the Standard Offer period; (2) provides an appropriate "last resort" safety net to those who have come back to utility service; and (3) makes provisions for a seamless and smooth transition, for residential and small commercial customers when Standard Offer ends. The Company looks forward to reading all of the intial comments in this proceeding and intends to file Supplement Comments on or before September 9, 2002.